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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 765

THE GRAYSON SHOPS INCORPORATED (OF CALIFORNIA), NAME CHANGED TO GRAYSON-ROBINSON STORES, INC.,
Petitioner,

v.

HERBERT B. STONE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

DAVID MARRAY,
Counsel for Petitioner.

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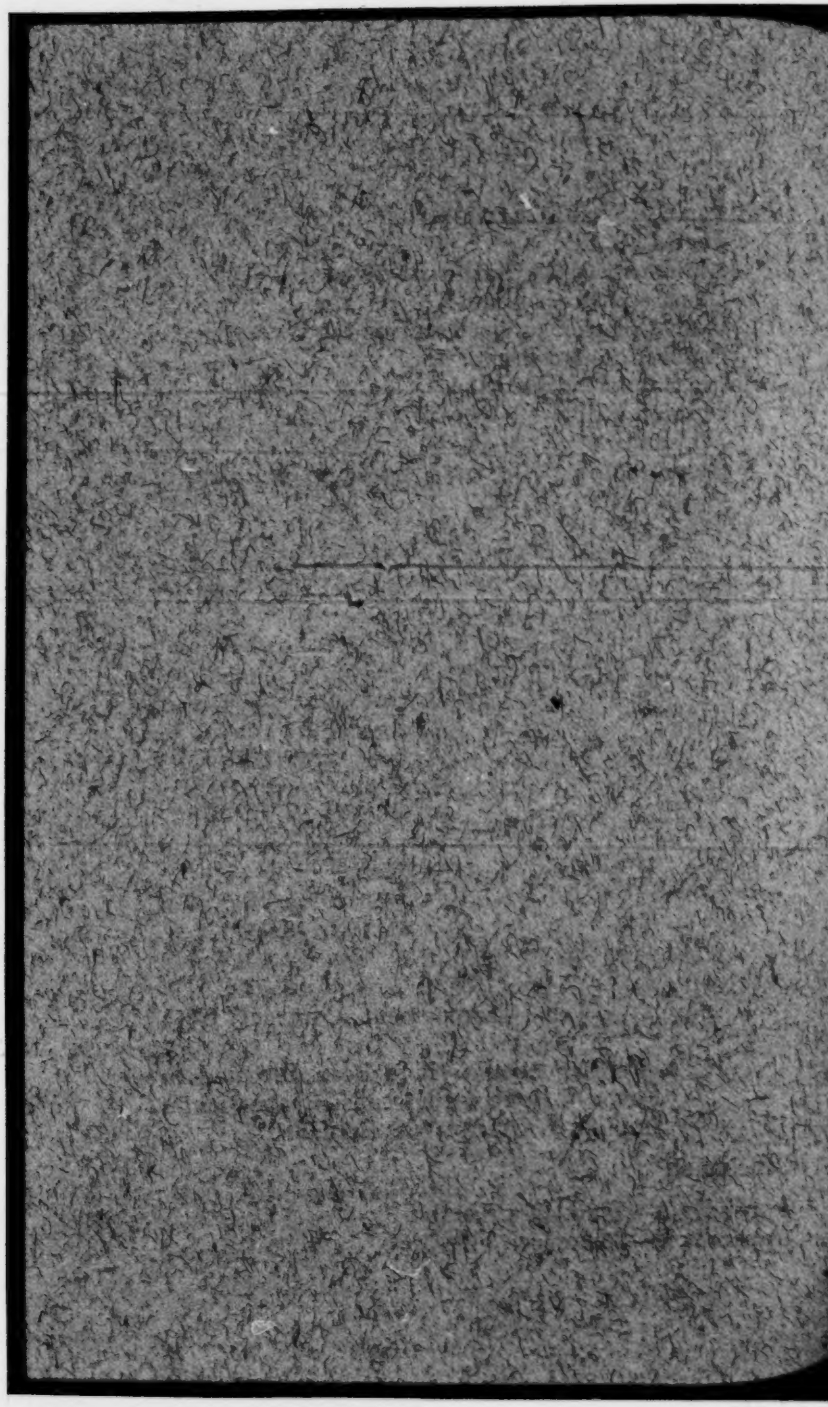

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The petitioner herein prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit, entered March 16, 1949 (R. 197), affirming a judgment in the sum of $166,491.40 in favor of the plaintiff-respondent in the United States District Court for the Southern District of New York (R. 177), entered on a directed verdict after a trial before a jury, and

an order of said District Court denying petitioner's motion for a new trial and for a directed verdict in favor of petitioner (R. 182-183). On April 5, 1949 the Court of Appeals entered an order denying rehearing but modifying its opinion (R. 208).

Jurisdiction

The jurisdiction of this Court is invoked under Section 1254 (1) of Title 28, United States Code.

Statement of the Matter Involved

This action was removed to the District Court on the ground of diversity of citizenship. Respondent brought the action, which was tried before a jury, on a written agreement (herein called "letter agreement"), executed and providing for performance in New York, by which, among other things, he agreed to assign to petitioner, a California corporation, his rights under an employment contract with S. Klein On The Square, Inc. (herein called "Klein") and petitioner agreed to pay him $200,000 (R. 49-50, 152). Petitioner had also, in a separate agreement (herein called the "securities agreement"), on the same day contracted to purchase the outstanding securities of the Klein corporation (R. 49-50, 151). The purchase price of the securities had been tentatively fixed prior to the commencement of negotiations with respect to the letter agreement (R. 103-104).

Petitioner defended against respondent's action on the grounds that it had agreed to purchase respondent's employment contract in order to relieve Klein of its obligations to respondent under that contract (R. 109); that respondent had expressly and impliedly warranted that his contract was not subject to unilateral termination by Klein, when the fact was that respondent, while serving as president of the corporation under the contract, had unlawfully converted to his own personal use $63,000 of Klein's funds

(which he subsequently returned) (R. 85, 87-89, 92, 98-100, 129-130, 137-139, 140, 175-176), and had defrauded Klein of a claim of $5,000 against himself by misrepresentations to the board of directors and the stockholders (R. 67, 73-75, 108, 128, 157, 169-171); and that these facts, unknown to Klein or petitioner until after the closing pursuant to the letter agreement (R. 108, 127-129, 130, 138), would have allowed Klein to terminate the employment contract without any cost to itself or petitioner.

A verdict having been directed in respondent's favor after the presentation of evidence by both parties, the Court of Appeals affirmed on the ground that petitioner's depredations as president were "technical irregularities," finding it "inconceivable that the Klein corporation would have tried to rescind the contract" on their account; interpreted the express oral warranty to mean only that Stone was surrendering a valuable contract which would not be rescinded by Klein; and that "So understood, the statement [i.e., the express warranty] was true, for, in assigning his contract, and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned" (R. 195-6). Respecting the defense of implied warranty the Court of Appeals agreed that "ordinarily, an assignor of a contract right makes an implied warranty 'that the right, as assigned, actually exists and is subject to no limitations or defenses other than those stated or apparent at the time of the assignment'—Restatement of Contracts, Sec. 175", but it held that no such warranty is to be implied where the assignment is taken not to exploit the right assigned, but to release the obligor from his duties (R. 196).

Questions Presented

1. Whether the direction of a verdict by a Federal Court constitutes a denial of trial by jury as guaranteed by the

Seventh Amendment and is erroneous under Rule 38 (a) of the Federal Rules of Civil Procedure—

(A) where on the issues of fact (i) there is substantial evidence in the record in support of the case of the opposing party; (ii) the jury could find for the opposing party without speculation; (iii) the Court rejects the testimony of witnesses testifying in support of the opposing party; (iv) the Court interprets a witness' own words, the witness having stated the substance of what he heard, and fails to give those words their ordinarily accepted meaning; and/or (v) the Court fails to make every reasonably possible inference in favor of the opposing party;

(B) where determination of the issues of fact depend upon a finding as to the purpose of the parties in entering into a contract and the interpretation thereof, and the Court makes its findings on the basis of the statements and acts of the parties from which conflicting inferences may be drawn and with respect to which there is conflicting evidence;

(C) where the issue is the interpretation of an oral express warranty which may be interpreted reasonably in a manner other than that adopted by the Court;

(D) on the record in this case.

2. Whether under New York law an oral warranty that a contract is "free from infirmities" means, as a matter of law, merely that as a practical matter such contract would not be rescinded.

3. Whether under New York law a warranty may not be implied with respect to a purchased item which is not intended to be exploited.

4. Whether under New York law the conversion of $63,000 of corporate funds, and corporate personalty and the fraudulent procuring of the write-off of $5,000 in per-

sonal charges on the corporate books, all by a director-officer constitutes merely "technical irregularities," or whether such acts create an infirmity in the employment contract which such officer-director had with such corporation.

5. Whether the District Court erred in refusing to grant petitioner's motion for a directed verdict based upon an implied warranty and the respondent's conversion of corporate funds which was subsequently discovered by petitioner and was admitted by respondent at the trial.

6. Whether a District Court, exercising diversity jurisdiction, may make an inference as a matter of law from specified facts, where such inference is not permitted by the law of the state in which the District Court sits and which governs the case.

7. Whether a District Court, exercising diversity jurisdiction, must leave to the jury an issue which would be so left by the law of the state in which the District Court sits and which governs the case.

Reasons Relied On for Granting the Writ

1. The United States Court of Appeals for the Second Circuit has affirmed a District Court judgment based on a directed verdict on grounds which seriously conflict with the decisions of this Court and of Courts of Appeal of other circuits construing the Seventh Amendment and the rules governing direction of verdicts.

(A) On testimony that the substance of respondent's oral warranty to petitioner was that his employment contract was valuable, valid and subsisting and free from infirmities (R. 105-6, 109, 115), the Court of Appeals found that respondent had only warranted that the contract would not, as a practical matter, be re-

scinded by Klein, his employer (R. 195). In so interpreting the warranty, the Court below either passed unfavorably on the credibility of the witness, which this Court has held it may not do, *Baltimore & O. R. Co.* v. *Groeger,* 266 U. S. 521, 524; *Gunning* v. *Cooley,* 281 U. S. 90, 94; *Tennant* v. *Peoria & Pekin Union R. Co.,* 321 U. S. 29, 35 *Lavender* v. *Kurn,* 327 U. S. 645, 652-653; *Ellis* v. *Union Pacific R. Co.,* 329 U. S. 649, 653, or failed to give the words used by the witness in his testimony their ordinarily accepted meaning. The jury would be free to find that the witness intended his words to convey their usual meaning, since this Court has held that where conflicting inferences may be drawn, the issue is one for the jury, *Ellis* v. *Union Pacific R. Co.,* 329 U. S. 649, 653; *Lavender* v. *Kurn,* 327 U. S. 645, 652-653; *Barreda* v. *Silsbee,* 21 How. (62 U. S.) 146, 167, and the probative value and weight of the evidence are also for the jury. *Baltimore & O. R. Co.* v. *Groeger,* 266 U. S. 521, 524; *Barreda* v. *Silsbee,* 21 How. (62 U. S.) 146, 167; *Barney* v. *Schneider,* 9 Wall. (76 U. S.) 248, 253; *Hickman* v. *Jones,* 76 U. S. 197, 201; *Gunning* v. *Cooley,* 281 U. S. 90, 94; also *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery,* 6th Cir., 74 F 463, 465 (Taft, C. J.).

(B) With respect to other findings, too, the Court below rejected the testimony favorable to petitioner's case, and made a choice among the conflicting inferences which could have been made therefrom. (See cases cited in preceding sub-paragraph.) Thus, the Court found that petitioner's purpose was to rid Klein, its prospective subsidiary, of respondent's employment contract without a lawsuit (R. 196-197), although there was testimony that petitioner purchased respondent's rights in reliance on his representations that the employment contract was free from infirmities (R. 105-106, 109, 115-6). The only basis for the Court's finding is that Klein was a prospective subsidiary of petitioner, and petitioner purchased respondent's rights under an employment contract with Klein. From this the jury would be as free to infer that petitioner purchased only

because it believed Klein could not otherwise terminate the contract.

(C) The Court below found that petitioner would have purchased respondent's rights even had it known Klein could terminate because it obtained from respondent a restrictive covenant and his consent to the sale of the securities (R. 196), the latter element having been inferred from the execution of the letter agreement and securities agreement on the same day. Where two contracts are executed the same day between the same parties, the fact may be, and a jury can conclude, that the two are separate. Moreover, there was testimony that one was not consideration for the other (R. 105). There was also testimony that petitioner did not desire the restrictive covenant and that the covenant was included in the letter agreement merely to accommodate respondent's tax purposes (R. 107-8).

(D) The Court below found that petitioner's purchase of the rights under the employment contract to enable Klein to terminate the contract, demonstrated an intent, as a matter of fact, that no warranty should be implied with respect to Klein's power to terminate the contract (R. 196). The contrary inference, being fully as reasonable, could have been made by the jury.

(E) Respondent, in his testimony, acknowledged converting $63,000 in corporate funds (R. 84, 87-9, 98-100, 130, 137-140, 175-6) and there was evidence that he fraudulently procured the write-off of $5,000 in personal charges on the corporate books (R. 67, 73-5, 108, 127-8, 157, 169-171), and converted some corporate personalty (R. 94-5). The Court of Appeals found that these acts were "technical irregularities" for which it was "inconceivable" that Klein would terminate the contract (R. 196). First, there was not a shred of evidence from which the Court could have found what Klein would have done and, even assuming such evidence, its evaluation would have been within the exclusive province of the jury. Second, the light view the Court took of respondent's misconduct can

only be due to its acceptance of respondent's testimony that he revealed the facts to everyone and obtained the informal consent of all, and its rejection of the testimony supporting petitioner's case that neither Klein nor petitioner knew of respondent's misconduct (R. 108, 127-130, 138). Since all of these findings rest upon a choice of possible inferences on conflicting testimony, the Court of Appeals erred in failing to draw all reasonably possible inferences in favor of petitioner on respondent's motion for a directed verdict. *Gunning* v. *Cooley*, 281 U. S. 90, 94; *Galloway* v. *United States*, 319 U. S. 372, 395.

(F) Not only did the Court of Appeals reject testimony favorable to petitioner and make a choice among conflicting inferences on its finding with respect to the intent of the parties, but in relying upon circumstances dehors the agreement in making its finding, it violated the principle established in *Rankin* v. *Fidelity Ins. T. & S. C. Co.*, 189 U. S. 242, 252, which requires that such an issue be left to the jury.

(G) Returning to the oral warranty, and assuming, *arguendo*, that the Court of Appeals reasoned that it had the actual wording thereof before it rather than the witness' interpretation of those words, the Court gave the wording of the warranty an extraordinary meaning which could only have been given it by the jury under the Ninth Circuit's decision in *Butte & B. Consol. Mining Co.* v. *Montana Ore Purchasing Co.*, 121 F. 524, 528, Since the accepted meaning was a more probable indication of the intent of the parties, the warranty was ambiguous if we assume that the extraordinary meaning given by the Court was a possible one, and the issue of interpretation was for the jury under the decisions in *Luse* v. *Martin*, 8th Cir., 215 F. 28; *Arkwright Mills* v. *Aultman & Taylor Machinery Co.*, 1st Cir., 145 F. 783; see *Kennedy* v. *National Tube Co.*, 3rd Cir., 255 F. 1, 3. Moreover, in making its interpretation, the Court relied on facts dehors the wording of the warranty, and was there-

fore required by the decisions of this Court to leave the issue to the jury. *Etting* v. *Bank of United States*, 24 U. S. 59, 75; *Barreda* v. *Silsbee*, 21 How. (62 U. S.) 146, 167; *West* v. *Smith*, 101 U. S. 263. See also *United States Steel Products Co.* v. *Poole-Dean Co.*, 9th Cir., 245 F. 533, 537; *Sinclair Refining Co.* v. *Refiners Oil Co.*, 6th Cir., 75 F. (2d) 851, 852; *International Glass Co.* v. *Krause*, 3rd Cir., 282 F. 206, 208.

(H) The Court sustained the direction of a verdict against petitioner although there was at the very least substantial evidence tending to support petitioner's case, and the jury could have found for petitioner without speculation. The issues were required to be left to the jury under the decisions of this Court. *Gardner* v. *Michigan Central R. Co.*, 150 U. S. 349, 361; *Galloway* v. *United States*, 319 U. S. 372, 395; *Tennant* v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 32-33; Also *Garrison* v. *United States*, 4th Cir., 62 F. (2d) 41, 42; *Travelers Ins. Co.* v. *Randolph*, 6th Cir., 78 F. 754, 759-760 (Mr. Justice Harlan); *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery*, 74 F. 463, 465, 470, 473, 475, 477 (Judge, later Mr. Justice, Lurton); see *Felton* v. *Spiro*, 78 F. 576, 582 (Judge, later Mr. Chief Justice, Taft).

Moreover, similar departures from established principles governing the direction of verdicts, although not as extreme, have occurred in the Second Circuit in a sufficient number of cases involving issues other than negligence as to urgently commend to this Court's discretion the exercise of its power of supervision. Instances of such departures are to be found in: *Benz* v. *Celeste Fur Dyeing & Dressing Corp.*, 156 F. (2d) 510; *Wasilowski* v. *Park Bridge Corp.*, 156 F. (2d) 612; *McCarney* v. *Scott*, 146 F. (2d) 624; *Henjes* v. *Aetna Ins. Co.*, 132 F. (2d) 715, cert. denied 319 U. S. 760; *Bush* v. *Order of United Commercial Travelers*, 124 F. (2d) 528. And compare the unfavorable comments on jury verdicts of the writer of the opinion below in the instant case appearing in *Skidmore* v.

Baltimore & O. R. Co., 167 F (2d) 54, cert. denied 335 U. S. 816; also *Roth* v. *Goldman*, 172 F. (2d) 788, 795, n. 30.

2. The United States Court of Appeals for the Second Circuit, in affirming a judgment of the District Court entered after a directed verdict, decided the following important questions of local law in a manner in conflict with applicable local decisions.

(A) The Court of Appeals held that where two contracts are signed the same day and the two parties are parties to both contracts, the signing of one is consideration for the signing of the other although the contracts do not so provide and although there is no testimony to that effect. The decisions of the New York courts are to the contrary. *Topken, Loring & Schwartz, Inc.* v. *Schwartz*, 249 N. Y. 206, 208, 211; *Petze* v. *Leary*, 117 App. Div. 829.

(B) The Court of Appeals held that a warranty may not be implied with respect to an item not purchased for exploitation. The decisions of the New York courts are to the contrary. *Carleton* v. *Lombard, Ayers & Co.*, 149 N. Y. 137, 146; *Becket* v. *Smithers*, 50 N. Y. Super. Ct. (18 Jones & Spencer) 378, 385.

(C) The Court of Appeals held that the following acts by a director-officer of a corporation having an employment contract with said corporation constitute only "technical irregularities": converting corporate funds in the aggregate sum of $63,000 and some corporate personalty; and fraudulently procuring the write-off from the corporate books of personal charges aggregating approximately $5,000. The New York courts have held that such acts, and less serious acts, constitute grounds for which an employer may terminate an employment contract. *Gray* v. *Shepard*, 147 N. Y. 177, *Lamdin* v. *Broadway Surface Advertising Corp.*, 272 N. Y. 133; *Hutchinson* v. *Washburn*, 80 App. Div. 367; *Katz* v. *Goodman*, 176 N. Y. Supp. 488.

3. The United States Court of Appeals for the Second Circuit, in affirming a judgment of the District Court, entered after a directed verdict, has rendered a decision in conflict with that of the United States Court of Appeals for the Sixth Circuit in *Motor Wheel Corp.* v. *Rubsam Corp.*, 92 F. (2d) 129, cert. denied 304 U. S. 560. The former court held an issue to be one of law for the court, although under the applicable local law the issue was one for the jury. Under the Sixth Circuit decision such an issue should be left to the jury. Specifically, the Second Circuit:

(A) held that the proper interpretation of an oral warranty is for the court although a different interpretation would be, at least, as reasonable; whereas, under the New York decisions, the interpretation would constitute an issue for the jury. *Debany* v. *Rosenthal*, 152 N. Y. Supp. 1043;

(B) made inferences from facts from which conflicting inferences could just as reasonably have been drawn. Under New York law, the making of such inferences would constitute an issue for the jury. *Henry & Co.* v. *Talcott*, 175 N. Y. 385, 393.

Conclusion and Prayer

For the reasons stated it is respectfully submitted that this petition to review the judgment of the United States Court of Appeals for the Second Circuit should be granted.

DAVID MACKAY,
Counsel for Petitioner.

EMANUEL L. GORDON,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinion Below

The District Court wrote no opinion. The opinion of the United States Court of Appeals for the Second Circuit (p. 44, infra) as modified (R. 193, 208) is reported at 173 F. (2d) 135 [1]

Jurisdiction

The basis for this Court's jurisdiction is set forth in the Petition at page 2.

Errors Below Relied upon Here and Summary of Argument

We respectfully refer the Court to the Reasons Relied on for Granting the Writ set forth in our Petition, at which place the errors below relied upon here, together with a summary of our argument, are set forth in such form as to make further introductory exposition here merely repetitious.

I

Petitioner Has Been Denied a Trial by Jury as Guaranteed by the Seventh Amendment

Over-liberal use of the directed verdict can make serious incursions into the constitutional right to trial by jury in civil actions at law (*Lavender* v. *Kurn*, 327 U. S. 645; *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649). Jury trial cannot be saved from such incursions unless this Court is willing, as it has been in the past, to consider, in individual cases,

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[1] The modified opinion as reported varies from the certified text in that it erroneously includes in the second paragraph the words "if we regard it as sufficiently proved."

whether there was enough evidence on the side of the losing party to require the case to go to the jury. The departures in the instant case from established principles relating to direction of verdicts are, we submit, so extreme as to require the exercise of this Court's power of supervision, "for any seeming curtailment of the right to trial by jury should be scrutinized with the utmost care." *Dimick* v. *Schiedt*, 293 U. S. 474, 486; *Bollenbach* v. *United States*, 326 U. S. 607, 615; see Mr. Justice Murphy dissenting in *Galloway* v. *United States*, 319 U. S. 372, 396, 407.

This was a diversity suit, and consequently no verdict should have been directed if either the Seventh Amendment or applicable local law required it to be submitted to the jury. *Slocum* v. *New York L. Ins. Co.*, 228 U. S. 364, 376-377; *Motor Wheel Corp.* v. *Rubsam Corp.*, 9th Cir., 92 F. (2d) 129, cert. den. 304 U. S. 560. The decisions of this Court and of other Circuits interpreting the requirements of the Seventh Amendment, as well as applicable New York law, required many of the issues determined by the Courts below to be submitted to the jury.

This Court has held that "a case should not be withdrawn from the jury unless the conclusion follows as a matter of law that no recovery can be had upon any view which can properly be taken of the facts the evidence tends to establish." *Gardner* v. *Michigan Central R. Co.*, 150 U. S. 349, 361. *Hickman* v. *Jones*, 9 Wall. (76 U. S.) 197, 201; *Iasige* v. *Brown*, 17 How. (58 U. S.) 183, 196; *Barreda* v. *Silsbee*, 21 How. (62 U. S.) 146. While there are cases which speak in terms of authorizing a directed verdict for one party if there is insufficient evidence upon which a jury may properly find for the opposing party (*Coughlan* v. *Bigelow*, 164 U. S. 301, 309), still, in considered and exhaustive opinions by the United States Court of Appeals for the Sixth Circuit, written by Mr. Justice Harlan, Judge (later Mr. Chief Justice)

Taft, and Judge (later Mr. Justice) Lurton, it has been held that a verdict may not be directed for one party merely because a verdict in favor of the opponent should be set aside by the court. *Mt. Adams & E. P. Inclined Ry. Co.* v. *Lowery*, 74 F. 463, 465, 470, 473, 475, 477; *Travelers Ins. Co.* v. *Randolph*, 78 F. 754, 759-760; See *Felton* v. *Spiro*, 78 F. 576, 582. *Accord: Garrison* v. *United States*, 4th Cir., 62 F. (2d) 41, 42. The view expressed in these circuits has been recently affirmed by decisions of this Court. In *Galloway* v. *United States*, 319 U. S. 372, 395, the test is stated as follows:

> "Finally, the objection appears to be directed generally at the standards of proof judges have required for submission of evidence to the jury. But standards, contrary to the objection's assumption, cannot be framed wholesale for the great variety of situations in respect to which the question arises. Nor is the matter greatly aided by substituting one general formula for another. It hardly affords help to insist upon 'substantial evidence' rather than 'some evidence' or 'any evidence' or vice versa. The matter is essentially one to be worked out in particular situations and for particular types of cases. Whatever may be the general formulation, the essential requirement is that mere speculation be not allowed to do duty for probative facts, after making due allowance for all reasonably possible inferences favoring the party whose case is attacked."

Accord: Tennant v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 32-33, 35.

It will be demonstrated below that in the instant case petitioner had made more than a sufficient showing to entitle it to go to the jury, and that the Court below reached the contrary conclusion by making a determination with respect to the credibility of petitioner's witnesses, by rejecting the testimony given and by resolving conflicting inferences in favor of respondent.

A. PETITIONER'S PURPOSE WAS TO RELIEVE KLEIN OF THE BURDEN OF AN OBLIGATION WHICH IT COULD NOT OTHERWISE TERMINATE, AND PETITIONER OBTAINED AN EXPRESS WARRANTY THAT THE EMPLOYMENT CONTRACT WAS FREE FROM INFIRMITIES.

Petitioner contended that its agreement to pay $200,000 for the purpose of enabling Klein to terminate the employment contract was premised on the assumption that that purpose could not be achieved free of charge—that Klein did not already have a right to terminate the contract with respondent for which petitioner was agreeing to pay $200,000. It supported that contention by testimony that respondent had expressly warranted that his contract was "a valid and subsisting one, free from infirmities", and by the implied warranty which the Court below conceded is "ordinarily" made by the assignor of a contract right—"that the right as assigned . . . is subject to no limitations or defenses other than those stated or apparent at the time of the assignment" (R. 196). The evidence establishing the facts will be discussed after the analysis of their legal significance.

(1) *The Legal Significance of the Facts*

If there was a breach of contract by respondent, petitioner could terminate any further performance on its part and recover damages in addition. *Breiterman* v. *Breiterman*, 239 App. Div. 709; *Hurst* v. *Trow Printing & Bookbinding Co.*, 2 Misc. 361, aff'd 142 N. Y. 637; *Cummings* v. *Standard Harrow Co.*, 55 Misc. 601, aff'd 124 App. Div. 915, aff'd 195 N. Y. 513

There are a number of grounds upon which rescission is available. If respondent had made knowingly false statements upon which petitioner relied, petitioner is entitled to rescission, *Adams* v. *Gillig*, 131 App. Div. 494, aff'd 199

N. Y. 314, even though no damage appears, *Downey* v *Mallison*, 232 App. Div. 703. Rescission may also be had if respondent made an innocent misrepresentation of a material fact upon which petitioner relied. *Bloomquist* v. *Farson*, 222 N. Y. 375, 380; or if there was a mutual mistake of fact, *Webb* v. *Odell*, 49 N. Y. 583, 585; *Flynn* v. *Smith*, 111 App. Div. 870, 873; or even if *petitioner* made a unilateral mistake of a material fact. *Rosenblum* v. *Manufacturers Trust Co.*, 270 N. Y. 79, 85; *In re Clark's Estate*, 233 App. Div. 487; *Batto* v. *Westmoreland Realty Co. Inc.*, 231 App. Div. 103; *Seidman* v. *N. Y. Life Ins. Co.*, 162 Misc. 560.

Rescission may also be had for a partial breach of contract or partial failure of consideration "which strongly tend[s] to defeat the object of the parties in making the contract." *Callanan* v. *K. A. C. & L. C. R. R. Co.*, 199 N. Y. 268, 284-285; *Clark Contracting Co.* v. *City of New York*, 229 N. Y. 413; *Fossume* v. *Requa*, 218 N. Y. 339; *Webb* v. *Odell*, 49 N. Y. 583, 585; *Mindheim* v. *Mindheim*, 21 N. Y. S. (2d) 372.

Under New York law a party seeking rescission need not tender back the benefits received, but the court may make appropriate provision therefor in its judgment. N. Y. C.P.A. Sec. 112-g (see p. 43, *infra*). It is immaterial whether petitioner is entitled to termination or rescission. Under rescission, petitioner would obtain the $50,000 which it paid respondent but would have to restore to respondent the value of the restrictive covenant.[2] If damages were awarded to petitioner based upon termination, the measure thereof would yield the same result as under rescission. Petitioner sought to acquire certain rights under a contract not terminable by Klein; but the employment contract involved in the deal *was* terminable by Klein. Petitioner's damages consist of what it paid respondent less the value

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[2] See footnote, p. 18, infra.

of what was received, the restrictive covenant. *Nelson* v. *Hatch*, 70 App. Div. 206, aff'd 174 N. Y. 546.

Petitioner bargained for rights under a contract which Klein could not unilaterally terminate, in order to free Klein of the burden of the contract. The failure of consideration occurred because, although Klein was freed of that obligation, it could have been freed without making any payment. *Tams-Witmark Music Library, Inc.*, v. *New Opera Co.*, 298 N. Y. 163. The employment contract had been terminated before the facts were discovered, and there was nothing further for petitioner to do in order to terminate or rescind its agreement.

It may be pointed out that the same result would have followed even if petitioner had acquired the rights under the employment contract in order to exploit them. In that case, as assignee, petitioner would take respondent's rights subject to the same defenses which Klein would have had against respondent. *Matter of Nunez*, 226 N. Y. 246. Klein would not be estopped to raise the defenses because it first learned of them after petitioner's closing with respondent. *Union Trust Co. of Rochester* v. *Allen*, 239 App. Div. 661. Petitioner could recognize the validity of Klein's defenses and recover from respondent upon proof thereof. *McConkey Realty Corp.* v. *Wildermuth*, 214 App. Div. 395, 397; *National Metal Edge Box Co.* v. *Gotham*, 125 App. Div. 101. Moreover, petitioner's bargain was with respondent and was for a certain kind of right. If those rights were not of the type bargained for, there was a failure of consideration without regard to the position Klein might take. *Nelson* v. *Hatch*, 70 App. Div. 206, 211-212, aff'd 174 N. Y. 546.

Accordingly, petitioner's case should have been sent to the jury if there was substantial evidence tending to prove that petitioner bargained for rights under a contract which Klein could not unilaterally terminate and that bargain constituted the essence of the agreement between petitioner

and respondent; *or* that petitioner entered into the agreement under the mistaken belief that the employment agreement was not subject to termination by Klein, and that belief was material; *or* that respondent innocently misrepresented that the employment contract was not subject to termination by Klein, and that misrepresentation was material and petitioner relied thereon; *or* that petitioner secured an express oral warranty that the employment contract was not subject to termination by Klein and obtaining rights under that employment contract constituted the essence of the petitioner's agreement with respondent. We shall now demonstrate that the requisite evidence is present in the record.

(2) *The Object of the Contract and the Warranties*

On January 27, 1946, Mr. Diamond, on behalf of petitioner, tentatively reached an agreement with the Klein officials for the purchase of its outstanding securities (R. 103-104). The following day, Diamond negotiated with respondent, himself an attorney (R. 44), for the acquisition by petitioner of the latter's rights under an employment contract with Klein.[3] That employment contract, executed April 5, 1944, provided for the employment of respondent by Klein until April 14, 1949 at a salary of $25,000 (later increased to $30,000), plus 5% of the annual net profits, for serving as president of Klein and executive director of the store (R. 11, 21, 22, 46-48, 150). For the fiscal year ended September 30, 1944, respondent's share of the profits under the employment contract was $4,309.96 (R. 142).

[3] The letter agreement resulting therefrom provided that in the event of a closing under the securities agreement, respondent would assign to petitioner his rights under the employment contract, resign as an officer and director of Klein, and restrict his business activities as specified. Petitioner agreed to pay $50,000 down and $150,000 in installments subject to acceleration upon default (R. 152). The latter two promises are discussed at pp. 27-29, infra.

Respondent offered to sell his rights under the employment contract to petitioner for $200,000 (R. 105). Diamond testified that respondent had represented to him, and that he had relied on the representation, that the employment contract was a valuable contract which had some time to run, and which provided for a participation in profits in addition to a fixed salary; and that respondent further represented, in substance, that the employment contract was a valid and subsisting contract, free from infirmities (R. 105-106, 109, 115). On cross-examination, the following appears in the record (R. 115-116):

> "Q. Now you told Mr. Mackay on direct examination that among other things Mr. Stone said to you, 'I have a valid and subsisting contract, free from infirmities.' You said that, didn't you? A. Well, in substance. I am not sure those were the words, but that was the meaning of what was said.
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> • • • • • • •
>
> Q. When you said on direct examination that Mr. Stone said to you that he had a valid and subsisting contract free from infirmities, you did not intend to convey to the jury that those were his exact words, did you? A. I did not, no, sir.
>
> Q. In other words, what you meant was that was your understanding of what Mr. Stone was saying to you, is that it? A. That is right.
>
> Q. You don't now contend that Mr. Stone said to you 'My contract is free from infirmities'—A. Well, if he did not——
>
> Q. In that exact language? A. Well, if he did not, I would not insist that is what he said."

That the substance rather than the exact words of respondent was given does not prevent the establishment of an express warranty. *John A. Crowley Co.* v. *Clark Equipment Co.*, 2d Cir., 263 F. 58; *Petty* v. *Fish*, 30 Misc. 828. Moreover, the testimony had been admitted and remained

in the record without objection, and therefore must be considered as evidence like any other probative facts, and the Court of Appeals so recognized when it revised its opinion upon denial of the petition for rehearing (R. 201, 208; see p. 44, *infra*). *Schlemmer* v. *Buffalo, etc., Ry.*, 205 U. S. 1, 9; *Diaz* v. *U. S.* 223 U. S. 442, 450; *Rowland* v. *Boyle*, 244 U. S. 106, 108; *Spiller* v. *Atchison, etc., Ry.*, 253 U. S. 117, 130; *Opp Cotton Mills, Inc.* v. *Administrator*, 312 U S. 126, 155; *Gross* v. *R. & S. Outfitting Co.*, 140 N. Y. Supp. 115. Respondent, it is true, denied making any representations, but that conflict merely raised an issue of credibility which the Court could not take from the jury. *Baltimore & O. R. Co.* v. *Groeger*, 266 U. S. 521, 524; *Gunning* v. *Cooley*, 281 U. S. 90, 94; *Tennant* v. *Peoria & Pekin Union R. Co.*, 321 U. S. 29, 35; *Lavender* v. *Kurn*, 327 U. S. 645, 652-653; *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649, 653; *Garrison* v. *U. S.*, 4th Cir. 62 F. (2d) 41, 42; *Howard* v. *Louisiana & A. Ry. Co.*, 5th Cir. 49 F. (2d) 571.

Under New York law, "any representation" made by the seller "of the state of the thing sold, at the time of the sale will amount to a warranty" (*Chapman* v. *Murch*, 19 Johns (N.Y. 290)). One of the important tests in determining whether a representation is one of fact or of opinion is the relative knowledge of the parties concerning the subject matter of the statement. *Titus* v. *Poole*, 145 N. Y. 414, 426; *Coleman* v. *Simpson, Hendee & Co.*, 162 App. Div. 335, 336. In view of respondent's expert status (he is himself an attorney (R. 44)) and his monopoly over the information relating to his misconduct, there is no question but that his representation was one of fact. At the very least, whether the representations constituted a warranty was an issue for the jury.[4] *Hercules Powder Co.* v. *Rich*,

[4] In any event, since the representation was material and petitioner relied thereon, petitioner would be entitled to rescind if it was false.

8th Cir., 3 F(2d) 12. Although the Court below originally found no express warranty (see p. 44, infra), it subsequently altered its opinion to assume that such a warranty was given (R. 208). Our objection relates to the finding with respect to the content of the warranty.

The Court of Appeals stated (R. 195-196, 208):

> "We shall, however, regard the express warranty as given. But it appears to us to mean only that Stone was surrendering a valuable contract which would not be rescinded by Klein. So understood, the statement was true, for, in assigning his contract, and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned. His contract was a good one, in the practical sense that Stone's relationship with Klein company was such that he could expect employment at the contractual rate for the duration of the contract term. It is inconceivable that the Klein corporation would have tried to rescind the contract on account of the technical irregularities alleged."

But Diamond, in stating the substance of what had been represented to him by respondent, testified that he had been told that the employment contract was free from "infirmities". That testimony the Court below completely ignored in its opinion.[5] If the Court was thus expressing its view of the credibility of the witness it was improper under the authorities cited above. If, however, the Court thought that it was accepting that testimony, as it must, but was interpreting it to mean only that Diamond was reporting that he had been told by respondent that "the Klein company had never questioned" the contract, then the Court was rejecting the ordinary meaning of the words used by the witness. It was also passing over testimony

[5] We pass over the Court's interpretation of the word "valuable" as meaning subjectively valuable to respondent—an interpretation entirely out of context in the light of respondent's superior knowledge.

that Klein was then not aware that respondent had abused his trust, and that it consequently had a right to terminate his contract. (See Point I, B, infra).

An "infirmity" is a defect or a weakness. The first and obvious meaning, and the one the jury would be clearly justified in giving to the testimony of the witness, is that Diamond had been told, in substance, that the employment agreement could not be unilaterally terminated by Klein prior to its expiration date.

Moreover, the meaning ascribed by the Court yields absurd results. Petitioner was acquiring control of Klein. Respondent knew of the securities agreement since he was a party thereto, and, as will be shown below, also knew that the employment contract was subject to termination because of his own prior misconduct. Surely he was not, under these circumstances, warranting to the party about to obtain control of Klein that the employment contract "would not be rescinded by Klein" (as the Court below interpreted the warranty). Respondent could not possibly know what petitioner would do when it controlled Klein and petitioner would not be interested in being told what it *would* do. Petitioner only desired to know what it *could* do.

The probative value and inferences to be drawn from the testimony were issues for the jury. *Baltimore & O. R. Co.* v. *Groeger*, 266 U. S. 521, 524; *Barreda* v. *Silsbee*, 62 U. S. (21 How.) 146, 167. On a motion for a directed verdict the court must make "all reasonably possible inferences favoring" the opposing side. The Court's failure to ascribe to Diamond's testimony its obvious meaning leads inevitably to the conclusion that the Court was weighing the evidence and rejecting the veracity of the witness, or his understanding, or the accuracy of his report, all being within the sole competence of the jury.

We may proceed further and assume, *arguendo*, that respondent actually spoke the words used by Diamond in

his summary. Still, the Court below erred in giving to the wording of the warranty a meaning not ordinarily accepted. If the possibility exists that such an extraordinary meaning was intended, the issue of interpretation is for the jury. *Butte & B. Consol. Min. Co.* v. *Montana Ore Purchasing Co.*, 9th Cir., 121 F. 524, 528. Moreover, it has been held that where a contract is partly written and partly oral, the interpretation thereof constitutes an issue for the jury. *United States Steel Products Co.* v. *Poole-Dean Co.*, 9th Cir., 245 F. 533, 537; *Hoffman* v. *American Mills Co.*, 2d Cir., 288 F. 768, 772, cert. denied 263 U. S. 701. If the extraordinary meaning is a possible interpretation, the accepted one is even more clearly so. The warranty was thus rendered ambiguous and, for this reason too, its interpretation was for the jury. *Arkwright Mills* v. *Aultman & Taylor Machinery Co.*, 1st Cir., 145 F. 783; *Luse* v. *Martin*, 8th Cir., 215 F. 28; see *Kennedy* v. *National Tube Co.*, 3rd Cir., 255 F. 1, 3; *Debany* v. *Rosenthal*, 152 N. Y. Supp. 1043.

It should be further noted that in its original opinion (p. 45, infra) the Court below described Diamond's testimony as "vague" with respect to the warranty.[6] If the Court so believed, that was all the more reason to refer the issue of interpretation to the jury.

As will be discussed under Point II, there was also an implied warranty that the employment contract was not subject to unilateral termination by Klein. Entirely apart from the express warranty, this should have barred the direction of a verdict against petitioner. As appears in Point II, the Court of Appeals erred in holding that a

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[6] The Court utilized the supposed vagueness as a ground for refusing to find that an express warranty had been given. In its petition for rehearing, petitioner argued that Diamond's testimony could mean only that the employment contract was not subject to termination by Klein, and hence was not vague (R. 202). In its modified opinion the Court withdrew the description "vague".

warranty may not be implied with respect to an item not purchased for exploitation. At this point we note that the Court below found "on the facts" that no implied warranty existed. It said an implied warranty exists "where the facts do not show a contrary intention. Assuming, *arguendo*, that the contract right here was subject to a defense which was not apparent, we think the facts disclose such a contrary intention, since defendant did not intend to exploit the contract" (R. 198). If, as the Court held, the issue is one of fact under New York law, then the jury would be free to draw an inference contrary to that drawn by the Court. Petitioner sought to enable Klein to terminate the employment contract, and the purchase of respondent's rights for $200,000 would have been unnecessary if Klein could unilaterally terminate them.

Diamond also testified that he had relied upon the foregoing representations made to him by respondent (R. 109). The inescapable inference from such testimony, and certainly one that the jury could clearly have entertained, is that petitioner, had it known of the infirmities in the employment agreement, would not have agreed to pay respondent anything, but would have effected the termination of the employment contract when it acquired control of Klein. From the testimony with respect to the representations and reliance, the inference was clearly permissible that petitioner's purpose was to obtain, and it bargained to obtain, rights under an employment contract which was not subject to unilateral termination by Klein. If the contrary inferences made by the Court below were logically permissible, they could be made only by the jury within whose sole competence lies the choice among conflicting inferences, even from the undisputed facts and under both Federal and State cases. *Ellis* v. *Union Pacific R. Co.*, 329 U. S. 649, 663; *Henry & Co.* v. *Talcott*, 175 N. Y. 385, 393. And where the purposes and objects of the parties

must perforce rest upon all the circumstances of the transaction, beyond the mere language of the contract, the issue must be referred to the jury. *Rankin* v. *Fidelity Ins. T. & S. D. Co.*, 189 U. S. 242, 252; *Ohio & Michigan Coal Co.* v. *Clarkson Coal & Dock Co.*, 6th Cir., 266 F. 189, 192.

The Court below found that petitioner's object was to get rid of respondent without a lawsuit or dispute (R. 196-197) notwithstanding that there is no support whatever for such a finding in the record. The Court arrives at that conclusion relying on two facts: (1) that petitioner had entered into another contract to purchase the Klein securities, and (2) that petitioner entered into the letter agreement with respondent to purchase respondent's rights under the employment contract. The conclusion is inconsistent with Diamond's testimony and ignores the sheer magnitude of the $200,000 purchase price as compared with what respondent was to receive under the employment contract itself. Moreover, the conclusion even without these contradictory facts is based on sheer speculation. The Court below does not have the expertise of an administrative agency in the field of purchasing control of a corporation which might be pointed to in support of such an inference. Cf. *S E C* v. *Chenery Corp.*, 332 U. S. 194. If getting rid of respondent without a lawsuit was not petitioner's object, and Klein could have terminated the employment contract with respondent, there was a failure of consideration. The fact that respondent left his employment without a dispute or lawsuit does not constitute consideration if petitioner did not bargain for it. *Tams-Witmark Music Library* v. *New Opera Co.*, 298 N. Y. 163.

The Court below concluded that petitioner would not have altered its bargain had it known the true facts (R. 196). This determination rests in part upon the premise, already shown to be erroneous, that petitioner was interested only in avoiding a lawsuit. However, the Court also relied for

its conclusion on the theory that petitioner obtained other benefits, the negative covenant on the part of respondent and his consent to the sale of the Klein securities (R. 196). There is nothing in the record to show that of these supposed other benefits, the former played any significant role or that the latter constituted any part of the letter agreement.

Negotiations had been pending for the purchase by petitioner of the Klein securities. On January 27, 1946, at a conference among Handmacher, Schwartz and respondent representing Klein, and Diamond representing petitioner, it was tentatively agreed that the securities of Klein would be sold to petitioner for $2,500,000 (R. 103-104). Thus, the securities agreement had already been negotiated when, on January 28, 1946, the respondent negotiated the letter agreement with Diamond for the sale of respondent's rights under the employment contract with Klein (R. 104). Both agreements were executed on February 2, 1946 (R. 49-50, 151).

During the negotiations on the letter agreement. Diamond testified that he had informed respondent that petitioner would not give respondent anything more for his stock than the other stockholders were receiving, and respondent had agreed to negotiate on that basis (R. 105). Thus, the finding of the Court below that respondent's consent to the sale of the stock (which was one of the rights attaching to the stock) constituted part of the consideration for the letter agreement was expressly negatived by testimony which the Court was required to accept on a motion for a directed verdict. Moreover, respondent, who testified at the trial, made no claim to the contrary. Indeed, respondent had a fiduciary obligation to the other security holders of Klein not to obtain more for his stock than they obtained for theirs. Hence, the only basis for the Court's finding that respondent sought to violate his fiduciary obligation rests

upon the fact that the securities and letter agreements were executed on the same day. The "reasonably possible inference" in favor of petitioner from the fact of execution on the same day is certainly not that one agreement constitutes consideration for the other but that the two are separate and distinct.

Moreover, the Court's finding is in direct conflict with the law of New York. In *Petze* v. *Leary*, 117 App. Div. 829, it was alleged that an employment contract had been made between plaintiff and a corporation of which defendant was an officer and stockholder. Simultaneously, plaintiff and defendant executed an agreement pursuant to which defendant agreed to give the plaintiff additional consideration if plaintiff carried out his contract with the corporation. The Court held that it could not be inferred from these facts that the execution of the contract with the corporation constituted part of the consideration furnished by plaintiff to defendant. *Accord: Topken, Loring & Schwartz, Inc.* v. *Schwartz*, 249 N. Y. 206, 208, 211.

The second item of additional consideration mentioned by the Court below was the negative covenant of respondent. In this instance the Court's unwarranted rejection of Diamond's testimony is clear. The securities agreement provided that for a period of 21 years none of the officers, directors, debenture holders or stockholders of Klein (including respondent) would, under the name "Klein" or an imitation or simulation thereof, engage in or become interested in any capacity in a business similar to or competitive with the business conducted by Klein (par. 1(n), R. 49, 151). Petitioner's object was made clearer when it consented to a clarification thereof on February 9, 1946 affirmatively permitting the restricted persons (including respondent) to engage in a competitive business provided it was not under the "Klein" name (R. 55-56, 165-166). Diamond testified that after he had agreed to a purchase

price of $200,000 for respondent's rights under the employment contract, respondent came to him and requested the inclusion of a restrictive covenant on his part so that he could claim that the proceeds of the sale constituted a capital gain (R. 107). Diamond informed respondent that although petitioner was not interested in obtaining a restrictive covenant barring him from engaging in a competitive business, it had no objections to respondent's including such a provision (R. 107-108).[7] In the face of this testimony it is difficult to see how, on a motion for a directed verdict against petitioner, the Court below could find that petitioner would not have altered its bargain had it known of the infirmities of the employment contract because it desired the restrictive covenant. It may be that the written agreement cannot be varied by parol to eliminate the restrictive covenant as technical consideration flowing to petitioner. However, "the consideration of a written instrument is always open to inquiry and a party may show that the design and object of the agreement was different from what the language, if alone considered, would indicate". *Baird* v. *Baird*, 145 N. Y. 659, 664; *Hutchison* v. *Ross*, 262 N. Y. 381, 398; *Van Kamen* v. *Roes*, 20 N. Y. Supp. 548, aff'd 144 N. Y. 685; *Smith* v. *Dotterweich*, 200 N. Y. 299, 305; *International Assets Corp.* v. *Axelrod*, 245 App. Div. 300; *O'Neill Supply Co.* v. *Petroleum H. & P. Co.*, 280 N. Y. 50, 55-56; *Fire Insurance Ass'n.* v. *Wickham*, 141 U. S. 564.

We proceed to negative another item of possible consideration, the third (and last) promise contained in the letter agreement. In the event of a closing under the securities agreement, respondent promised to resign as an officer and director of Klein and of its subsidiaries (R. 49-

[7] The covenant provides that for a period of six years respondent would refrain from assuming an executive position in a ladies apparel department store in Manhattan (R. 152).

50, 152). However, in the securities agreement, respondent had agreed to deliver his resignation as an officer and director of Klein and of its subsidiaries at the closing under that agreement (par. 4(a), R. 49, 151). The promise in the letter agreement would thus become effective only in the event that respondent had already resigned. Even if the two agreements were executed simultaneously, the promise to resign in the letter agreement would not constitute consideration. *Petze* v. *Leary*, 117 App. Div. 829.

Since the promise to resign does not constitute consideration, and petitioner neither desired nor bargained for the restrictive covenant, it follows that the essential purpose of the parties, the essence of the deal, was the attempted acquisition by petitioner of rights under an employment contract which Klein could not unilaterally terminate.

B. RESPONDENT HAD SO MISCONDUCTED HIMSELF AS TO CREATE INFIRMITIES IN THE EMPLOYMENT CONTRACT WITH KLEIN

We have shown that petitioner had bargained for rights under a contract which Klein could not unilaterally terminate. We shall now demonstrate that petitioner did not obtain what it bargained for.

On two occasions, respondent converted corporate funds, once in the sum of $50,000, and once in the sum of $13,000. On August 11, 1944, respondent drew a check on the Klein account in the sum of $50,000 to his own order (R. 84, 137-138). The check stub read "Herbert Daniel Stone—Even Exchange—$50,000" (R. 139, 176). This stub was posted to a private ledger under an account labeled "Even Exchange" without any further identification or explanation (R. 140). The money was used by respondent to repay part of a personal loan from Marine Midland Trust Co. (R. 99-100). Respondent had borrowed $150,000 from the bank to purchase, along with a group of other persons, previously issued securities of Klein from the prior owners

of those securities (R. 98-99). Of the $150,000, respondent used $100,000 to purchase securities for himself, and $50,000 for other members of the purchasing group (R. 99). Respondent's use of corporate funds never appeared on any Klein financial statement (R. 130). Respondent claimed at different points in his testimony that he had notified the members of the executive committee of the board of directors (R. 85), and all of the directors informally (R. 92) of his conversion, each time specifically naming the chairman of the board of directors as one of the persons with whom he discussed the matter and from whom he had obtained approval. However, Mr. Handmacher (chairman of the board) testified (R. 128-129) that he not only did not consent to the conversion but knew nothing of it until he had been served with a subpoena to testify at the trial in this action. The $50,000 was returned on August 30, 1944 (R. 140).

On September 5, 1944, respondent drew a check on the Klein account in the sum of $13,000 to his own order (R. 87-88). This was recorded in exactly the same fashion as the previous withdrawal of $50,000 (R. 140, 175, 176). Again the directors of Klein were not notified (R. 129-130), although respondent made the same contentions to the contrary, and the transactions did not appear on any Klein financial statement (R. 130). The money was used by respondent to purchase some real estate for himself (R. 89), and was returned to the corporation on September 28, 1944 (R. 89). Respondent argued that he had believed the $13,000 was due to him as his share of the net profits of Klein pursuant to the employment contract. However, the net profits were "to be determined at the end of each fiscal year" (R. 11, 22) pursuant to the employment contract, and the fiscal year did not terminate until September 30, 1944 (R. 141). Hence, respondent was not entitled to draw any

corporate funds on that score until after September 30, 1944; and, then, he was only entitled to $4,309.66 (R. 142).

These conversions were unknown to petitioner until after respondent assigned his "rights" under the employment contract. None of the entries on the check stubs or in the accounts revealed that respondent had withdrawn the funds for personal use, as was acknowledged by the person who was auditor for Klein at the time the transactions occurred, (R. 138). No misconduct is involved in an even exchange which involves an immediate exchange of a check for cash or its equivalent but the term certainly does not cover a net withdrawal of funds constituting a defalcation by a corporate executive.

Moreover, no investigation was ever conducted by petitioner with respect to the letter agreement. Provision was made for an investigation in the securities agreement (par. 6, R. 49, 189, infra, p. 42) because the securities agreement contained various escape clauses permitting petitioner to terminate the agreement (par. 7, R. 49, 189, infra, p. 42). Pursuant to the securities agreement, petitioner's attorneys had possession of the Klein minute books for approximately three days prior to sending the notice that petitioner was ready to close (R. 117-118, 119, 162). There is nothing in the record to show that any books were examined with respect to the letter agreement. Of course, even if the financial records, as distinguished from the minute books, had been examined, and the entries discussed above observed, still, petitioner could not have known therefrom of respondent's conversions.

The defalcations were also unknown to the Klein directors. Thus when the Court of Appeals emphasizes the fact that the Klein corporation had never questioned the employment contract, it was really making a statement of little

significance, for the directors could not question what they did not know.

Under New York law "The rule is well settled that the officers and directors of a corporation occupy positions of trust in relation to their company and to its stockholders, and in all their dealings are bound to act with fidelity and in the utmost good faith . . ." *Winter* v. *Anderson*, 242 App. Div. 430, 431. Under Sec. 59 of the N. Y. Stock Corporation Law (infra, p. 43), no corporate funds may be lent to a stockholder except by a moneyed corporation. Since Klein was not a moneyed corporation [N. Y. General Corporation Law, Sec. 3 (6), infra, p. 43], any loan to respondent who was a stockholder was unlawful. *Murray* v. *Smith*, 166 App. Div. 528, modified on another point 224 N. Y. 40. Moreover, the withdrawal by a corporate officer of corporate funds for personal use constitutes a conversion of the funds, *Quintal* v. *Kellner*, 264 N. Y. 32, 35, even if the directors approve such withdrawal. *Marcus* v. *Otis*, 2d Cir., 168 F. (2d) 649.

Respondent had also fraudulently procured the write-off from the Klein books of personal charges against him for merchandise in the sum of $4,394.49 at cost and $5,359.13 at ticket price (R. 73-74). Respondent falsely represented to petitioner and to the directors and stockholders of Klein that he had distributed the merchandise for the good and welfare of Klein, and thereby procured the consent of petitioner and of Klein to writing off these charges (R. 67, 74-75, 108, 128, 157, 169-171). Respondent claimed that he had revealed the personal nature of the charges to Diamond who requested respondent to have false resolutions entered in the directors' and stockholders' minutes, and that although false minutes had been entered both the directors and stockholders had actually been correctly informed. Diamond, however, denied that respondent had notified him

of the personal nature of the charges and that he (Diamond) had requested respondent to have false minutes drawn (R. 108). Handmacher, chairman of the Board of Klein, testified that both the directors' and stockholders' minutes correctly stated what had occurred at the meetings and that respondent had represented to the directors and stockholders that the merchandise had been distributed for the good and welfare of Klein (R. 127). There was also testimony, again denied by respondent, that the latter had converted some personal property belonging to Klein while he was president of the corporation (R. 94-95).

These acts of misconduct which the Court below labeled as "technical irregularities" for which it was "inconceivable that the Klein corporation would have tried to rescind the contract" (R. 197), would clearly justify termination of the employment contract under New York law. What is inconceivable is that the Court could so characterize respondent's acts if it accepted the testimony supporting petitioner's case, as it must. The conversion of large sums of corporate funds, and dealing falsely with directors and stockholders are scarcely within the category of irregularities. Converting an employer's property, dishonesty, and bad faith are accepted grounds upon which a contract may be terminated in New York, *Hutchinson* v. *Washburn*, 80 App. Div. 367; *Gray* v. *Shepard*, 147 N. Y. 177; *Katz* v. *Goodman*, 176 N. Y. Supp. 488, and even for which past salary earned need not be paid. *Lamdin* v. *Broadway Surface Advertising Corp.*, 272 N. Y. 133, 137; *Sundland* v. *Korfund Co., Inc.*, 260 App. Div. 80.

There was thus ample evidence in support of petitioner's claim that it bargained for rights under an employment contract which Klein could not unilaterally terminate, and that it obtained an express oral warranty that the contract respondent had with Klein fell within that category.

The infirmities in that contract created not only a partial failure of consideration and partial breach of contract defeating the essential purpose of the bargain, but clearly revealed a mistake as to a material fact on petitioner's part, and fraud on respondent's part on which petitioner relied. Since the latter includes innocent misrepresentation of a material fact which is relied upon, a case has also been made out for relief on that ground.

II

A Verdict Should Have Been Directed in Favor of Petitioner Because Respondent's Implied Warranty Was Breached

The fact that a contract is in writing does not negate the existence of an implied warranty. *Hoisting Engine Sales Co.* v. *Hart*, 237 N. Y. 30, 35. Nor does the fact that an express warranty was made, not inconsistent with the implied warranty, preclude the existence of the latter. *Rinaldi* v. *Mohican Co.*, 225 N. Y. 70, 73. Nor does the language of the sale and assignment employed in the letter agreement negate the existence of an implied warranty that the employment contract was valid and subsisting and free from grounds upon which it could be terminated. The Court of Appeals did not suggest otherwise.

Respondent agreed to assign to petitioner all his "right, title, equity and interest in and to" the employment contract. In the case of the sale of realty, this language would imply simply that respondent was quit-claiming whatever rights he had. However, that is not so, for obvious reasons, in the case of a sale or assignment of the rights under a bilateral contract. A party to such a contract cannot transfer "his contract" since he has not only rights but also duties under the contract. The contract was as much the contract of Klein as of respondent. For this reason the ordinary language of the form books used to assign rights

under a bilateral contract is that which appears in the letter agreement. (See e. g., 7 Williston on Contracts, Form 165 at p. 5899, Form 166, Form 176).

An implied warranty is an obligation imposed by law in the interests of justice "to enable the purchaser to get what he paid for" *McClure* v. *Central Trust Co.*, 165 N. Y. 108, 122. The New York courts have held that there is an implied warranty that any instrument sold "is what it purports to be" (*Ledwich* v. *McKim*, 53 N. Y. 307); that on the sale of a chose in action it is impliedly warranted that no defense exists (*Delaware Bank* v. *Jarvis*, 20 N. Y. 226, 229, 231); that on the sale of a judgment which was obtained by an execution levy it is impliedly warranted that title to the judgment is not defective by virtue of an improper levy (*Flandrow* v. *Hammond*, 148 N. Y. 129); that on the sale of a tax lien there is an implied warranty that the lien is genuine, valid and subsisting (*County Securities, Inc.* v. *Warwick Properties, Inc.*, 176 Misc. 272, 275-276, aff'd 263 App. Div. 964, modified on other grounds and aff'd 289 N. Y. 774). In *Enterprise Brewery* v. *J. C. G. Hupfel Brewing Co.*, 176 N. Y. Supp. 105, the court held that on the sale of a liquor license, there was an implied warranty that the license was not subject to termination because of prior violations of the liquor laws by the seller. In *Nelson* v. *Hatch*, 70 App. Div. 206, aff'd, 174 N. Y. 546, the court held that upon the assignment of a part interest in a contingent fee contract, the assignor impliedly warranted that he would carry out the contract in accordance with its terms even though the other party thereto consented to its modification. Cf. *Meyer* v. *Texas Lumber Co.*, 150 So. 407, app. den. by Sup. Ct. (See *Collins* v. *Jones*, 152 So. 802, 804).

Under New York law an implied warranty may be negated only by an express provision of the contract. However, it

may also be defeated by the presence of an element negating reliance, such as knowledge of the defect. *Carleton* v. *Lombard, Ayres & Co.*, 149 N. Y. 137, 146; *Becket* v. *Smithers*, 50 N. Y. Super. Ct. (18 Jones & Spencer) 378, 385.

The Court below, relying upon the Restatement,[8] held that an implied warranty may be negated by circumstances showing a contrary intention. In this respect, the Restatement goes beyond any New York case, but assuming, *arguendo*, that it does state the New York law, the Court below still erred in making its inference. The mere fact that rights are purchased under a contract in order to enable the other party to the contract to terminate it does not lead to the inference that the purchaser would have been willing to purchase the rights if the other party could have terminated the contract unilaterally. The party to be relieved may engage in self-help under those circumstances.

On respondent's own admissions referred to above (pp. 25-27), respondent converted $63,000 of corporate funds. Even if we accept his claim that the directors were notified, the character of the conversion is unaltered. *Marcus* v. *Otis*, *supra*; Cf. *Equity Corp.* v. *Groves*, 294 N. Y. 8, 11-13; *Flanagan* v. *Flanagan*, 77 N. Y. S. (2d) 682; *Zahn* v. *Transamerica Corporation*, 3d Cir., 162 F. (2) 36. The conversion of funds alone would be sufficient to warrant the termination of the employment contract.

By reason of the implied warranty and the respondent's undisputed conversion of funds, a sufficient case was made out of breach of contract and failure of consideration to justify either termination or rescission. Therefore, sufficient undisputed facts appear in the record to warrant a directed verdict for petitioner.

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[8] Only one New York case (the only case cited) was cited by the Court below and that with reference to a point it found unnecessary to decide.

Conclusion

Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit to review its judgment.

Respectfully submitted,

DAVID MACKAY,
Attorney for Petitioner.

EMANUEL L. GORDON,
of Counsel.

APPENDIX A [9]

Plaintiff's Exhibit 3

1. We do jointly and severally warrant, represent and agree as follows:

(a) S. Klein On The Square, Inc. (hereinafter referred to as the "Corporation") is a corporation duly organized and existing under the laws of the State of New York, having the following authorized capitalization:

20-year 8% Debentures in the principal amount of $800,000, due April 1, 1964, interest on which is payable semi-annually on the first days of April and October, said Debentures being subordinate to claims of creditors, all of which are duly issued, outstanding and fully paid.

10,000 shares of 8% Cumulative Preferred Stock with a par value of $100 per share, 2,000 shares of which are duly issued, outstanding, fully paid and non-assessable.

14,000 shares of Common Stock without par value, consisting of:

4,000 shares of Class A Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

4,000 shares of Class B Common Stock all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class C Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class D Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

1,500 shares of Class E Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable;

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[9] See R. 189.

1,500 shares of Class F Common Stock, all of which are duly issued, outstanding, fully paid and non-assessable.

All of said shares of Common Stock have equal rights and participation, except that the holders of the shares of Class A and Class B Common Stock are each entitled to elect three Directors, and the holders of the shares of Class C, Class D, Class E and Class F Common Stock are each entitled to elect one Director.

None of the above Debentures are in default and there are no dividend arrears on any of the said shares of Preferred Stock.

(b) Each of the persons, firms and corporations listed in Schedule "A" hereto annexed owns the principal amounts of said Debentures, and the numbers of shares of said Preferred and Common Stock set beside their respective names, which constitute all of the presently outstanding securities of the Corporation, and at the time of closing each will have the right to make the sale and transfer herein contemplated.

(c) As at the date of closing, there will be no options, commitments or other rights or liens in existence with respect to or against any of the said Debentures or shares of Preferred and Common Stock, either issued or unissued.

(d) The Corporation has never done business and has never been qualified to do business in any state other than New York.

(e) Since its organization, the Corporation has been engaged in the retail sale of women's clothing and accessories.

(f) The Corporation's only subsidiaries are:

Fourteenth Street Trading Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which engages in the operation of a restaurant on the Corporation's premises;

S. Klein Fur Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which engages in the operation of the fur department at the Corporation's premises.

S. Klein Trading Corporation, a corporation duly organized and existing under the laws of the State of New York, all of whose authorized shares of capital stock are duly issued and outstanding and are owned by the Corporation, which has done no business but which has applied for a New York State retail liquor license.

(g) The Corporation's fiscal year ends on September 30th. All tax returns of every kind required to be filed by or on behalf of the Corporation and its subsidiaries for all periods ended on or prior to the date hereof have been duly and properly filed, and all taxes of every kind payable by the Corporation and its subsidiaries for all periods ended on or prior to the date hereof have been duly paid. At the time of closing, all such tax returns for all periods ended on or prior to the date of closing hereunder will be duly and properly filed, and all such taxes for all periods ended on or prior to the date of closing will be duly paid, or reserves therefor will have been established and duly reflected on the books of the Corporation and of its subsidiaries.

(h) Neither the Corporation nor any of its subsidiaries is a party now engaged in any suits, actions or other legal proceedings; neither the Corporation nor any of its subsidiaries has received, within two years prior to the date hereof, any claims or demands stating or threatening that legal proceedings will follow a refusal on the part of the Corporation or any of its subsidiaries to comply with any such claim or demand and which, since receipt thereof, has not been settled without present liability to the Corporation and its subsidiaries, except such suits, actions, legal proceedings, claims and demands which are fully covered by insurance maintained by the Company for its benefit or the

benefit of its subsidiaries; there are no pending proceedings and the undersigned know of no contemplated proceedings by governmental authorities against the Corporation, its subsidiaries, or the properties thereof.

(i) The Corporation and its subsidiaries have made no agreements, commitments or contracts which as at the date of closing hereunder will be still outstanding, other than agreements, commitments and contracts referred to in Schedule "B" hereto annexed. As at the time of closing, neither the Corporation nor any of its subsidiaries will be in default with respect to any such agreements, commitments or contracts. As at the date of closing, the Corporation and its subsidiaries will have duly performed each and every term and condition on their parts to be performed pursuant to such agreements, commitments or contracts.

(j) The Corporation at December 31, 1945 had a net worth of not less than $1,300,000 represented by approximately $265,000 of fixed assets and approximately $1,035,000 in current and other net assets and at the time of closing hereunder the Corporation's condition will be substantially as above stated.

(k) The Corporation occupies the premises at which it presently conducts its business pursuant to lease dated April 11, 1944, which expires on April 15, 1965, and which contains an option in favor of the tenant to renew said lease as to all of the demised premises for a period of twenty-one years, and to successive options in favor of the tenant to renew as to all or part of said premises demised pursuant to terms and conditions therein specified. Said lease provides for rental during the term thereof and for the first renewal period of Three Hundred Thousand Dollars ($300,000) per annum, plus two percent of the gross business done at said premises by the tenant in excess of Twelve Million Dollars ($12,000,000) per annum.

(l) Between the date hereof and the date of closing hereunder, no new securities of the Corporation or its subsidiaries will be authorized or issued, no dividends will be declared or paid, and no liability will be incurred by said corporations or entered upon said corporation's books ex-

cept in the ordinary and regular course of business, and at the time of closing hereunder, the corporation will be conducting a going business of the nature, condition and with assets substantially similar to that conducted by it on the date hereof.

(m) Following the closing hereunder, none of the present officers, directors, Debenture holders or stockholders of the Corporation will employ or become associated in business with any of the present executive employees of the Corporation or its subsidiaries, unless said employees shall theretofore have ceased their employment with such corporations without interference or inducement, direct or indirect, by said officers, directors, Debenture holders or stockholders.

(n) Following the closing hereunder and for a period of twenty-one (21) years thereafter, none of the present officers, directors, Debenture holders or stockholders, under the name "Klein", or any imitation or simulation thereof, will anywhere engage in or in any manner whatsoever be or become interested in, directly or indirectly, as owner, partner, agent, stockholder, director, officer, employee or otherwise, in a business, trade or occupation similar to or competitive with the business presently conducted by the Corporation.

* * * * * * *

6. You are hereby granted permission to examine any and all records, documents and property of the corporation and its subsidiaries, such examination to be conducted by your attorneys, accountants or other representatives at all reasonable times and hours following the execution of this agreement and prior to the closing hereunder.

7. In the event that the investigation to be conducted by you shall disclose any substantial variance from the representations contained herein, you shall have the right to refuse to consummate the purchase herein contemplated, and in the event of such refusal the aforesaid sum of Two Hundred Fifty Thousand Dollars ($250,000) being delivered by you simultaneously with the execution and delivery of this agreement shall be forthwith returned to you by said

escrow agents and there shall be no further liability on the part of any party to the others. You may also designate a reasonable number of representatives who, between the date hereof and the time of closing hereunder or until you shall refuse to consummate the purchase herein contemplated, shall be permitted to be present at the Corporation's premises for the purpose of observing the Corporation's operations, facilitating the completion of your investigation, and otherwise preparing for the taking over of the business by you.

APPENDIX B

Statutes

New York Civil Practice Act, Section 112-g

> "Tender of benefits by party rescinding transaction. A party who has received benefits by reason of a transaction voidable because of fraud, misrepresentation, mistake, duress, infancy or incompetency, and who, in an action or proceeding or by way of defense or counterclaim, seeks rescission, restitution or other relief, whether formerly denominated legal or equitable, dependent upon a determination that such transaction was voidable, shall not be denied relief because of a failure to tender before judgment restoration of such benefits; but the court may make a tender of restoration a condition of its judgment."

New York General Corporation Law, Section 3(6)

> "A 'moneyed corporation' is a corporation formed under or subject to the banking law or the insurance law."

New York Stock Corporation Law, Section 59

> "No loan of moneys shall be made by any stock corporation, except a moneyed corporation, or by any officer thereof out of its funds to any stockholder therein, nor shall any such corporation or officer discount

any note or other evidence of debt, or receive the same in payment of any instalment or any part thereof due or to become due on any stock in such corporation, or receive or discount any note, or other evidence of debt, to enable any stockholder to withdraw any part of the money paid in by him on his stock. In case of the violation of any provision of this section, the officers or directors making such loan, or assenting thereto, or receiving or discounting such notes or other evidences of debt, shall jointly and severally, be personally liable to the extent of such loan and interest, for all the debts of the corporation contracted before repayment of the sum loaned, and to the full amount of the notes or other evidences of debt so received or discounted, with interest from the time such liability accrued."

APPENDIX C

Original Opinion

Stone v. *Grayson Shops, Inc.*

After stating facts as they appear at R. 193-196:

FRANK, *Circuit Judge:*

Defendant asserted as its chief defenses (1) fraud, (2) breach of an express warranty, and (3) breach of an implied warranty. We think the trial judge correctly decided that, in support of these defenses, there was not evidence sufficient to go to the jury. Diamond, an experienced lawyer, who appeared in this suit as defendant's counsel, merely gave his understanding of what plaintiff said to him, but did not narrate what plaintiff said. In the circumstances, such testimony was not enough to serve as a foundation for a defense of fraud or misrepresentation, or express warranty.[10]

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[10] We need not, therefore, decide whether oral testimony could be considered in support of an express warranty in the face of the written con-

Even, however, if such a vague express warranty was given, it appears to mean only that Stone was giving up a valuable contract which would not be rescinded by Klein. So understood, the statement, if we regard it as sufficiently proved, was true, for, in assigning his contract and agreeing to the stock sale, Stone was giving up something of great worth to him, something which the Klein company had never questioned. His contract was a good one, in the practical sense that Stone's relationship with the Klein company was such that he could expect employment at the contractual rate for the duration of the contract term. It is inconceivable that the Klein corporation would have tried to rescind the contract on account of the technical irregularities alleged.

To go a step further, we might assume as a fact that the Klein company has a remedy to recover from plaintiff any part of the funds or property allegedly converted. There is no evidence, however, as to how knowledge of this fact would have caused defendant to change the terms of its bargain with plaintiff; and, looking at the whole transaction, we think it would not make a sufficient difference to justify rescission of the contract between plaintiff and defendant. In addition to the desired benefit to defendant of getting rid of plaintiff's employment contract without a dispute or lawsuit, defendant obtained from plaintiff an agreement to refrain from assuming an executive position with any ladies' apparel department store in the borough of Manhattan for a period of six years, and also obtained the consent of plaintiff—an important figure in the negotiations—to the sale of the Klein stock.

Nor, on the facts, was there an implied warranty of the validity of the employment contract. While, ordinarily, an assignor of a contract right makes an implied warranty "that the right, as assigned, actually exists and is subject

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tract and written assignment. Cf. *Zacharia* v. *Osaka Textiles, Inc.*, 7 N. Y. S. (2d) 696.

Nor, as bearing on fraud or misrepresentation, need we take account of the fact that defendant had examined the corporate records and might therefore have known of the alleged infirmities in plaintiff's employment contract.

to no limitations or defenses other than those stated or apparent at the time of the assignment''—Restatement of Contracts, § 175—this rule applies only where the facts do not show a contrary intention. Assuming, *arguendo*, that the contract right here was subject to a defense which was not apparent, we think the facts disclose such a contrary intention, since defendant did not intend to exploit the contract. Looking at the whole situation, we agree with the trial judge that defendant obtained just what it bargained for. In purchasing the business, defendant wanted to replace the old officers and directors with its own staff of executives. To do so, it had to be rid of plaintiff, and therefore had to buy up or procure a release of his five-year contract. Obviously, defendant never itself intended to enforce that contract against the Klein corporation. Indeed, it could not have done so, for nothing would be due thereunder unless plaintiff continued to work for the Klein corporation. Patently defendant desired only to be free of plaintiff without a dispute or lawsuit. This the defendant got.

Defendant also argues that the assignment is invalid because there was not a quorum of disinterested directors present when the Klein corporation consented to the assignment. Perhaps such a consent would have been necessary if Grayson, as assignee, had intended to enforce the contract with the Klein company by naming plaintiff's successor. But here the purpose of the assignment was to terminate the contract with the Klein company, thus extinguishing plaintiff's rights thereunder; accordingly, so far as the defendant was concerned, there was no need to obtain the consent of the old management of the Klein corporation to the contract between the plaintiff and the defendant.

Affirmed.